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SHOULD THE U.S. ARMY IMPLEMENT A 401(K) SAVINGS AND INVESTMENT PROGRAM TO IMPROVE RECRUITMENT AND RETENTION OF SOLDIERS?

by

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Preface

Today's military is facing the most severe manpower challenges since the Vietnam War. With an expanding economy and low unemployment the competition for labor resources is great. Will the implementation of a 401(k) savings and investment program fix this problem? The establishment of a 401(k) program could be one small step in an attempt to increase recruitment and retain soldiers.

I could not have accomplished this report without guidance from my research advisor LTC Jeff Reilly. I also appreciate the Air University Library for their invaluable assistance.

Abstract

This study investigates the worth of a 401(k), savings and investment plan for the United States Army. My thesis statement is – Should the Army implement a 401(k) savings and investment program to improve recruitment and retention of soldiers?

The methodology I used was to look at the proposed changes to the military retirement system since 1993. There have been plenty of initiatives to change and ultimately reduce the military retirement system. My research focused on savings and investment programs that are of importance to soldiers. There has been talk of implementing some type of plan but that was all it turned out to be – talk.

Most recruits join for reasons other than money or some type of monetary payoff. Most join for the purpose of education, to learn a job skill, to travel or for patriotic reasons. I determined that most soldiers choose to leave the Army because of low base pay, reduced quality of life and increased amount of family separation. What is interesting to note here is that the category of retirement benefits was growing significantly as a reason for soldiers leaving the military.

I wanted to find out if there is a benefit to the Army in implementing a 401(k) program. I determined that there would be no additional duties for the Army personnel department in implementing a 401(k). The Federal Retirement Thrift Investment Board would implement and administer the 401(k) and I estimate that only 12 percent would

take advantage of the program. Today, IRA's are the only instruments soldiers can use for tax-deferred savings.

Ultimately, my research determined that the lack of a 401(k) program, as a single entity, has not caused the current decline in recruitment or retention in the Army. If a 401(k) program would be implemented today, it would not change the recruitment or retention rates of the Army. Increasing the current retirement benefits program and implementing a 401(k) will improve recruitment and retention. Surveys show that deteriorating retirement benefits are growing steadily as a reason for separation since 1992. The solution must include either changing the redux program to the Final Basic Pay Program (FBPP) or the High-Three Year Program (HTYP) and a pay raise

Chapter 1

Introduction

> *"They have received a very clear message that pay, which is now perceived as not being comparable with civilian levels...was becoming a contributing factor to retention."*
>
> Pentagon spokesman Capt. Mike Doubleday[1]

At the culmination of the Gulf War, the United States Army was at its peak end-strength. Saddam Hussein was soundly defeated on the battlefield. The cold war was also over with the collapse of the Soviet Union and the United States had no superpower rival. America was expecting a better state of peace and prosperity as the new-world order was upon us. Then the downsizing of the military took place. The American public wanted a peace dividend and a tremendous reduction of the military was the answer. The Army's contribution was to reduce active army divisions from 18 to 10.

Along with the reductions in the Army end strength, we also saw erosion of our medical and dental benefits. Military pay has not kept up with our civilian counterparts and quality of life suffered tremendously due to increased deployments. With the collapse of communism, we thought the world would be a more peaceful place. That has not been the case. Instead of focusing on one superpower enemy, the United States has become the world's policeman. "Between Fiscal Year 1989 (FY89) and FY98, Army deployments for missions have gone from an average of one every four years during the

Cold War, to 14 every four years in the post-Cold War era." This is according to the Army Posture Statement (FY99).[2] In essence, we are doing more with less. Soldiers are away from their families more than ever. The lower ranks feel the senior leadership has forgotten the importance of quality of life. Soldiers also see their civilian counterparts doing well financially as the economy continues to expand. Because of the reduction of quality of life, the erosion of benefits, and with military pay not keeping up with the civilian counterparts, recruitment and retention is suffering. Think tanks have recommended a series of measures such as increased pay. However, the most lucrative incentive for soldiers to remain on active duty is yet to be determined. Will a 401(k) investment and savings program help in the recruitment and retention of soldiers? That is what I intend to find out!

I am studying the effects of 401(k) plan on U.S. Army Readiness because I want to find out whether a comprehensive investment and savings plan would influence recruitment and retention. This paper will demonstrate the value such a program would have on the readiness on the U.S. Army and the quality of life for military soldiers and their families. First, I will examine what soldiers currently have for benefits, the current retirement system and the proposed changes. I will examine if money is a real motivator for soldiers to join or stay in the Army. Next, I will examine what effect a 401(k) program would have on the Army human resource system, and who would implement the program. I also will look at the costs of the program and determine if the lack of a savings and investment program affected combat readiness. Finally, I will examine the benefits a 401(k) may provide to the soldier and make a recommendation based on this research.

Notes

[1]Gannet News Service, "Pentagon mounts drive for better pay", *Montgomery Advertiser*, 1 November 1998.

[2] U. S. Army Posture Statement, *America's Army – One Team, One Fight, One Future,* February 1998, ix.

Chapter 2

Background of Current Benefits

> *"Within the five-year budget plan, if we continue on the mode we're on right now – of just balancing shortfalls and losing our quality people – we will be in a hollow force"*
>
> Gen. Michael Ryan, Air Force Chief of Staff[1]

There are currently three different military retirement plans. The first or oldest one is the Final Basic Pay Plan (FBPP). It applies to military members who entered military service before 8 Sep 1980. Under the formula, a retiree gets 50 percent of basic pay after 20 years of military service and an additional 2.5 percent for every year beyond 20, up to a maximum of 75 percent of base pay.

The second retirement plan is the High–Three-Year Plan (HTYP). It applies to military personnel who joined the service from 8 Sep 1980 through 31 Jul 1986. The formula for HTYP is similar to the final basic pay plan; 50 percent pay for 20 years of service. A 2.5 percent increase is added for each additional year of service over 20 years, up to 75 percent of base pay. The difference between the HTYP and the FBPP is that HTYP base pay is determined by computing the average of the highest 36 months of base pay.

A cost of living adjustment (COLA) is equally applied to the FBPP and HTYP plans. The COLA is computed annually from the consumer price index-workers.

Table 1 – Retirement Calculations of Current Active Duty Service Members

Short Form Reference	**Final Basic Pay**	**High-Three Year Average**	**Military Retirement Reform Act of 1986/Redux**
Applies to:	Persons in service before 8 Sep 1980	Persons joining service from 8 Sep 1980 thru 31 Jul 1986	Persons joining service after 31 Jul 1986
Basis of Computation (Retired Pay Base):	FINAL RATE OF MONTHLY BASIC PAY	Average monthly basic pay for highest 36 months of basic pay	Average monthly basic pay for highest 36 months of basic pay
Multiplier	2.5 percent per year of service	2.5 percent per year of service	2.5 percent per year of service, less 1.0 percent for each year of < 30 (restored at age 62)
Cost-of-Living Adjustment	Full Consumer Price Index – Workers (CPI-W)	Full CPI-W	CPI-W minus 1.0 percent (one-time catch-up at age 62)

Source: LTC Jack Faires et al., "Military Retirement – Is It Time To Change," Research Report no 19980820 044 (Harvard University SSC Fellows, USAWC Class of 1998)[2]

"The newest retirement plan is known in personnel circles as the "redux" plan," a name derived from the fact it "re-does" the retirement formula. Redux applies to those who entered the military on or after August 1, 1986.

Redux reduces the value of retired pay two ways. First, the formula provides only 40 percent of the average of the last three years of basic pay after 20 years of service, adding 2.5 percent for each additional year of service. This formula still allows a maximum of 75 percent of basic pay for 30 years of service. Also decreasing the value is a cap placed on annual cost-of-living adjustments. Under redux, the COLA for retirees will be one percentage point less than inflation, as measured by the Consumer Price Index (CPI). That limit was not included in the previous retirement plans.

Two adjustments are made at age 62, one permanent and one temporary. First, redux provides for a one-time pay adjustment when a retiree reaches age 62 to set the value at what it would have been if full inflation increases were provided. After the one-time adjustment, annual COLAs will continue to be capped at one percentage point less than the CPI. Second, and more significantly, retired pay is recomputed under a new formula that restores the value of the first 20 years of service to be worth 50 percent of the high-three of basic pay. For each additional year of service, retired pay is increased 2.5 percentage points. The maximum retired pay remains 75 percent of the highest three years of basic pay.

Which plan applies? Knowing which plan applies to you is not always clear because of complicated rules that determine when someone begins military service. Rules for deciding when someone first becomes a service member tend to favor officers, because time spent in Reserve Officer Training Corps (ROTC) or at the service academies counts as time in the military for retirement purposes. Military service begins at the earliest date of enlistment, induction or appointment in a regular or reserve component for a commissioned officer, warrant officer or enlisted member. A break in service will not affect when someone first becomes a member.

Enlisted members enrolled in the Delayed Entry Program (DEP) before beginning active service can count the day they signed their DEP contract as the start of their military service. That can add up to a year to their service time. The retirement plan for cadets and midshipmen at the service academies and those in (ROTC) is determined by the date their military education began.[3]

Proposed Changes to Military Retirement since 1993

> *"Secretary Cohen heard enough to be particularly worried about whether changes in the pension system back in 1986 are having a corrosive effect on retention today."*
>
> Ken Bacon, Defense Department Spokesman[4]

There have been numerous attempts to reduce or curb military compensation especially through the military retirement system. Seventeen different initiatives have taken place from 1993-1997. Most attempts, through draft legislation, focused on reducing the COLAs or changing the basic methodology for computing retirement compensation.

The seventeen proposed changes are as follows:

Table 2 – Military Retirement System Initiatives

Date	Authors	Features
November 1993	Kerrey-Brown	Deny COLAs for FY94-99 on Retired pay greater that $30K Zero COLAs until age 62 for new entrants.
November 1993	Penny Kasich	Zero COLAs until age 62 with catch-up at age 62
January 1994	Concord Coalition	Means-test Federal Comp/Benefits-<$40K= receive all benefit; -$40-50K=90%; -$50-60K=80%; progressively until $120K=15%
1994	Kerrey-Danforth Entitlement Commission	Change CPI Change CSRS/FERS formula Change MRRA-2%/YOS–drop; age 62-catch-up

April 1995	Gregg Proposals	Zero COLAs until age 62 Zero COLAs on retired pay>$14k Cut COLAs 0.5% below CPI
May 1995	S.822 Kerrey-Simpson	Means-tested COLAs – Social Security and MIL/CIV
May 1995	S.820 Kerrey-Simpson	Change MRRA to flat 2%/YOS and drop age 62 catch-up
October 1995	Blue Dog	Flat $ COLA for each retirement category
October 1995	FY96 Budget Reconciliation	High-1 for military members retiring after 1995 (CPI cut 0.2%/yr starting 1999)
May 1996	Simpson-Kerrey-Brown-Nunn-Robb (defeated 63-36)	CUT RETIRED PAY-IF RETIRE BEFORE 50 Limit COLAs to $50K of retired pay Set COLAs=CPI-.05%
May 1996	Chafee-Breaux (defeated 53-46)	DELAY MIL/CIV RET COLAS TO APR (THRU 03) Delay entitlement retired pay until 50 COLAs=CPI-0.5% in 98/99 COLAs=CPI-0.3% 00 and beyond
May 1996	Senate Budget Committee-Brown Amendment	Sense of Senate that mil/civ retirees COLAs should be capped
May 1996	House Budget Resolution	Delay mil/civ retiree COLAs until Apr (civ retirees'97 and on; mil retirees '98 and on)
May 1996	Senate Budget Resolution	Delayed Federal civilians COLAs to Apr thru 03
December 1996	Boskin Report	Assume CPI over states inflation by 1.1%/yr; Cap COLAs to reflect that
February 1997	Blue Dog	COLAs=CPI – 0.8%; Flat $ amount for COLAs

March 1997	CBO Options to Reduce the Deficit	Defer COLAs to age 62 COLAs limited to half CPI Cap COLAs 1% below inflation Cap COLAs on retired pay above poverty level Require military to contribute to their retirement Drop retirement multiplier from 3.5% at 20 YOS to 2.0% for new entrants

Source: Briefing Notes, Compensation and Entitlements Branch, subject: Uniformed Services Payroll Savings Plan, 6 May 1998[5].

What Savings and Investment Programs Have Been Attempted Before?

> *"1997 Army Family Advocacy Program (AFAP) voted Military Savings Account a top five issue."*
>
> Briefing on Uniformed Services Savings Plan[6]

A savings and investment program for the military has been kicked around for quite some time. The military's civilian counter-parts have enjoyed various savings and investment programs, while the military has not. Federal civilian employees participate in a program known as the Thrift Savings Program (TSP). You might say it is very closely related to the 401(k) that employees enjoy through civilian corporations.

As recently as 1990 the Armed Forces Tax Council developed a proposal that would establish a Military Family Savings Account. This system would mirror or would be very similar to the Thrift Savings Plan (TSP). As stated earlier the TSP is very similar if not the same in most cases as 401(k) programs. The Secretary of Defense for force management policy decided not to institute the program because it was not cost effective and the Department of the Treasury agreed to study the proposal. As with all bureaucratic agencies the study took quite some time and eventually the Treasury Department came out in staunch opposition, claiming this program was too costly.[7]

Because of the 1999 Unified Legislation and Budgeting (ULB) process, the thrift savings proposal was deferred for review until FY00. The United States Army and the United States Air Force were not in favor of some form of Uniformed Services Thrift Savings Plan (USTSP). The United States Navy and the United States Marine Corps are in favor of the USTSP. The Army felt that the USTSP, in its proposed form, would empower the politicians to revamp the current retirement system.[8] Another concern of the Army was that a USTSP would adversely affect retention. The portability of the program would not provide incentive for military members to continue to serve in their respective services.

The USTSP proposal would amend the U.S. Code to allow a member of the uniformed services to contribute up to 5% of their monthly basic pay. The Federal Retirement Thrift Investment Board would manage this contribution like an Individual Retirement Account (IRA) or a 401(k); the USTSP contributions and earnings would be tax deductible until withdrawn, starting at age 59 1/2. Earnings are taxed as ordinary income. What makes the USTSP unique to the federal employee's thrift savings plan or most corporations 401(k) programs is that the USTSP excludes government matching of funds to keep program costs low.[9]

Other features of the USTSP include before-tax savings and tax-deferred savings features. Investors have a choice of investing in three different funds, including government securities, bond and a common stock fund. The USTSP creates a special tax problem for the service members when other alternatives exist that apply to the general population. The Treasury Department frowns on special interest tax legislation and the USTSP requires it. The Individual Retirement Account (IRA) is in place for all to take advantage. Senator Roth is in the process of proposing another new IRA feature. Speculation is that it will allow all wage earners to participate in some type of 401(k) program with the unmatching feature. The bottom line is the new and expanded IRAs would offer similar benefits at no cost to the Department of Defense.

The U. S. Treasury estimated that the cost to run USTSP over five years is $95 million.[10] The office of economic manpower analysis department expects that 12% of service members will participate with an average contribution rate of 3%. The salaries of junior enlisted families may not allow for a consistent participation in the program. It is important to point out that while only 12 percent is expected to participate, quantity is not the only factor to consider. Quality of the force is also important especially with the implementation of Force XXI. Force XXI must be manned by our country's best and the 401(k) will help attract more affluent junior enlisted personnel. PAYGO requires that all new proposals that reduce revenue or increase expenses be offset from other programs. In other words there must be a bill payer to compensate for the $95 million estimated cost of the USTSP. This is a tremendous price tag just to run a savings and investment program. That is why Congress is saying - if you want USTSP, we will re-examine the entire military retirement system. The Army and the Air Force determined that price tag is too high!

What is the Motivation for Soldiers to Join the Army?

> *"Meeting this challenge will require a multiyear plan with the necessary resources to preserve military readiness, support our troops and modernize the equipment needed for the next century."*

President Bill Clinton

In determining if the Army should implement a 401(k) savings and investment program lets first look at why people join the Army. People join for many reasons. The table below outlines the reasons.

Table 3 – What Motivates People to Join the Army

Segments of Society	$ For Education	Work Skills	$ For Pay	Duty or Obligation	Travel
Women	36.2	17.3	9.7	8.8	5.8
Hispanic	M: 31.2 W 33.5	30.1 21.0	12.9 8.2	12.8 10.8	6.0 7.1
African American	M: 34.1 W: 37.8	23.2 20.7	18.1 10.0	8.4 1.3	9.5 9.9
High School Grads	M: 26.4 W: 29.9	29.3 20.8	12.1 9.0	10.4 9.4	12.4 7.9
High School Seniors	M: 36.5 W: 38.0	24.2 17.2	9.9 8.9	12.1 10.3	6.2 5.3
College Students	M: 29.7 W: 41.5	24.0 16.5	14.0 13.8	13.2 7.8	7.3 6.9

Source: Office of Economic and Manpower Analysis November 1998[11]

The table indicates that the largest percentage of recruits join the Army for education. Unfortunately, soldiers are choosing to join the Army less and less these days. The economy is doing very well, in fact, most say that this is the longest peacetime economic expansion ever experienced by this country. In these prosperous times, prospective recruits are finding an abundance of good jobs in this strong economy. Those that are not choosing to take a job right out of high school are going to college in record numbers. In 1997, 67 percent of high school graduates went to college. Legislation was passed in 1997 providing Hope Scholarships and Lifetime Learning Credits. This sweeping new legislation is similar in scope to the G. I. Bill of some fifty years ago in that it provides a large government investment in higher education. The

Hope Scholarship is designed to make the first two years of college available to those that qualify. The Lifetime Learning Credits are designed as tax credits for college beyond the first two years.[12] The Army has a lot of work to do if they are to compete in this area. The price of college continues to rise while the Army College Fund (ACF) has remained stagnant, not keeping pace with the increasing cost of a college education. "In 1985 the ACF covered 126 percent of college costs, compared to 93 percent in 1989 and 74 percent in 1998.[13]

Another way that the Army attracts prospective recruits is through the Enlisted Bonus (EB). This bonus system has fluctuated in scope over the years both by dollar value and through the different military occupational specialties (MOS). The Army uses EBs to attract individuals to hard to fill MOSs, including combat specialties such as infantry, armor, and artillery.

Paying the EB up front is not cost effective. If the soldier attrits, he or she still gets to keep the bonus. As long as the soldier gets through basic training and advanced individual training, the money is his. From the Army's perspective, once the money is spent, it is gone.

What is the Retention Rate of Mid-Career Soldiers?

> *"Addressing things like military pay and retired pay and health care benefits and housing quality is much easier in an environment when the defense budget is static or declining."*
>
> Pentagon manpower official[14]

The backbone of the Army is its soldiers. Soldiers are less interested in an Army career today for numerous reasons. The most prominent reason is due to the booming economy. So with less soldiers choosing to enter the Army there must be an increased effort to retain those soldiers that do join. The latest retention statistics are listed in the table below.

Table 4 – Retention Rates Since FY92

	FY92	**FY93**	**FY94**	**FY95**	**FY96**	**FY97**	**FY98**
Initial Term	30.7	46.1	49.2	45.6	46.5	54.2	53.6
Mid-Career	62.5	75.6	73.8	72.8	70.0	75.6	74.8

Source: Office of Economic and Manpower Analysis November, 1998[15]

The table indicates that the retention rates were low due to the drawdown period after Desert Shield and Desert Storm. As the drawdown leveled out, retention reverted to the pre-Desert Storm levels. From FY 84-91, the retention rate for first term or initial term soldiers was 42 percent and the retention rate for mid-career soldiers was 70 percent. What is important to point out here is that the retention rate peaked in FY97. It is now on a downward trend. The Army has taken steps to improve retention in the wake of lower recruitment numbers. For example, the Army instituted (several years ago) a selective re-enlistment bonus (SRB) for hard to fill MOSs and the bonus program has helped retention. It is important to understand that retention or re-enlistment is propensity driven. Monetary incentives can change retention. There are no other conceivable ways to improve retention short of spending money.

On the officer side of the house there is also a downward trend in accessions and retention. The ROTC is where the military gets the bulk of its officers and production has been slipping. One problem is that the military is expecting too many ROTC commissions from a declining non-scholarship production base. Today, in colleges across the United States, 66 percent of Army ROTC commissions are supplied by scholarship, this is primarily by deliberate design to get a greater return on their investment.[16] The table below indicates the past and estimated future production of officer accessions through ROTC.

Table 5 – Reserve Officer Training Corps Production

	Mission	Production
FY96	4275	4259
FY97	4175	4120
FY98	3800	3693
FY99	3800	3650 (estimated)

Source: United States Army Recruiting Command, Jan 1999.[17]

So with a decline in officer accessions there is also a problem with officer retention. Surveys indicate that there are a number of reasons for the decline in the retention of junior officers; officers below the grade of captain. Unfortunately, junior officers are slipping into the lower middle class. The standard of living for a college graduate that is about the same age is rising while the military officer's standard of living is not keeping pace. Today, Captains earn less compared to years past after you adjust for inflation. Since the drawdown there are more missions and with less forces to do the mission; there are definitely more family separations as a result. Additionally, we live in a world where spouses work outside the home in greater numbers than ever before and the military is no exception. With families living within the continental United States (CONUS) as well as outside the United States (OCONUS), the families OCONUS may have more of a burden. Some spouses prefer to work outside the home and while being deployed OCONUS, those job opportunities may not exist. It is often not possible for a spouse (with family) to get a job while serving in CONUS due to frequent, unpredictable deployments. Therefore, there is a greater degree of spousal income loss for military officers.

The last factor I will mention here is the dissatisfaction with the retirement system. A good portion of the force now falls under the redux program. They are making their dissatisfaction known in larger numbers and this is the primary reason why some are choosing to get out of the service. In FY92 the dissatisfaction rate among company grade officers was at 38 percent. In FY 97, over 65 percent of company grade officers were dissatisfied with the retirement benefits. The field grade officers are also dissatisfied with the retirement benefits although most of them fall under the HTYP or the FBPP. However, they too, see steady erosion of benefits. Their dissatisfaction in FY92 was at 38 percent and in FY97 it grew to over 50 percent.[18] The table below indicates the decline in junior officer retention.

Table 6 – Junior Officer Retention

Year	Officers Short	Percentage
FY96	1080	93.8
FY97	1147	93.2
FY98	1390	91.4

Source: United States Army Recruiting Command, Jan 1999.[19]

Other troubling trends indicate that company grade officers will leave the Army in increasing numbers after their obligation is expired. Current attitudinal data shows that junior officers are more likely to leave now than they were earlier in the decade. The data only goes as far back as 1995 but the trend is there. Forty-two percent of the second lieutenants say they will "probably" or "definitely" leave the Army at the end of their obligation. This is up 12 percent since 1995. Thirty-five percent of first lieutenants say they will "probably" or "definitely" leave the Army at the end of their obligation. This is up 6 percent since 1995. Finally, 22 percent of captains say that they will “probably” or “definitely” leave the Army at the end of their obligation. This is up 5 percent since 1995.[20]

What are the Reasons Behind 1st Term and Mid-Career Soldier Attrition?

> *“Meeting this challenge will require a multiyear plan with the necessary resources to preserve military readiness, support our troops and modernize the equipment needed for the next century.”*
>
> President Bill Clinton[21]

Considerable differences exist in the reasons individuals join the Army. It’s interesting to note that most enlisted recruits join the Army for “job training,” “college money,” “something I can be proud of,” and “prove myself.” The largest difference in enlistment motives among male and female recruits was for college money: 25 percent of males and 32 percent of females joined for college money. More high school graduates joined the Army for “college money” while non-high school graduates joined for the reason “do something they could be proud of.” The bottom line here is that the most desired recruits (high school graduates) join the Army for education benefits and job training. Most do not think of making money or retirement. At least they do not think of it yet!

Now lets look at reasons the enlisted soldiers leave the Army. The table below shows the trends.

Table 7 – Reasons Enlisted Soldiers Leave the Army

Reasons	1992	1993	1994	1995	1996	1997
Amount of Basic Pay	11.4	9.7	13.9	16.6	14.3	16.7
Overall Quality of Life	17.2	16.5	12.3	12.1	11.6	12.9
Amount of Time Separated From Family	15.4	11.9	8.5	8.4	11.2	10.4
Retire-Ment Benefits	1.3	1.7	2.2	3.7	7.1	9.7
Promo/ Advance-Ment Oppor-Tunities	9.8	7.4	9.5	10.4	9.1	6.3
Amount of Enjoy-Ment From Job	5.8	5.3	5.3	5.5	4.9	5.5
Oppor-tunity to Select a Job, Tng, or Station	N/A	2.6	4.7	4.1	2.8	3.7
Quality of Ldr ship & Mgmt	3.3	5.0	4.2	4.5	4.8	2.6
Job Security	5.1	3.5	4.0	2.8	3.0	2.5

Source: Army Research Institute.[22]

What is important to point out on this table is that the top four reasons for enlisted soldiers separating from the Army are very telling. Since 1992, sub-standard basic-pay, quality of life and amount of time separated from family have consistently been the major reasons soldiers separate from the Army. What is even more telling is that retirement benefits have been increasing in importance with the enlisted soldiers. Retirement benefits are now number four and will overtake the list in a couple of years at the current rate.[23]

Senior enlisted soldiers, or non-commissioned officers (NCOs), currently on active duty are also significantly dissatisfied with the retirement benefits. Junior NCOs (E5-E6) are about 80 percent dissatisfied while the senior NCOs (E7-E9) are about 78 percent dissatisfied.

I want to point out here that retirement benefits are not the only things that are high on the list of reasons for dissatisfaction. Medical care is also a big concern. Fifty-eight hospitals have closed and 17 others are reduced to clinics. Dental coverage for dependents now requires a premium and TRICARE is not free.[24] I just described three very important concerns of today's Army soldiers. The point of this section was to lay out the dissatisfaction with the current retirement benefits system as identified through enlisted and officer surveys.

Notes

[1] Tom Philpott, "Joint chiefs pull readiness alarm: "Redux fix" top priority", *Montgomery Advertiser*, 4 October 1998.

[2] LTC Jack Faires et al., "Military Retirement – Is It Time To Change," Research Report no 19980820 044 (Harvard University SSC Fellows, USAWC Class of 1998).

[3] Rick Maze, "Three Retirement Plans, One Choice—See Which Plan Will Apply To You," *Army Times*, May 26,1997, 14.

[4] Tom Philpott, "Defense chief wants larger military, retiree pay raises," *Montgomery Advertiser,* 18 October 1998.

[5] Briefing Notes, Compensation and Entitlements Branch, subject: Uniformed Services Payroll Savings Plan, 6 May 1998.

[6] *Ibid.*

[7] *Ibid.*

[8] *Ibid.*

[9] *Ibid.*

[10] *Ibid.*

Notes

[11] Report of Office of Economic and Manpower Analysis Department of Social Sciences, “The Labor Market for Soldier,” November 1998.

[12] Maj Hill and Maj Hauk, Information Paper on Deferred Incentive Program, 30 July 1998, 1.

[13] Maj Hill and Maj Hauk, Information Paper on Deferred Incentive Program, 30 July 1998, 3.

[14] Rick Maze, “Clinton: Military Needs More Money,” *Army Times,* 5 October 1998, 18.

[15] Maj John Jessup, Briefing on Propensity for Military Service, U.S. Army Recruiting Command, Jan 1999.

[16] *Ibid.*

[17] *Ibid.*

[18] *Ibid.*

[19] *Ibid.*

[20] *Ibid.*

[21] Rick Maze, “Clinton: Military Needs More Money,” *Army Times,* 5 October 1998, 19.

[22] Maj John Jessup, Briefing on Propensity for Military Service, U.S. Army Recruiting Command, Jan 1999.

[23] *Ibid.*

[24] *Ibid.*

Chapter 3

Is there a Benefit to the Army for a 401(k) Program?

"Nobody here is saying pay is the total answer, but it sends a very strong message to our people that we care about them."

Army Chief of Staff General Dennis J. Reimer[1]

So far I have detailed the background of military benefits outlined some past and current pay initiatives and described what motivates people to join the Army and why they are dissatisfied with the current retirement system. In this chapter, I will evaluate research to determine if there is sufficient reason for the Army to implement a 401(k) savings and investment program. I will examine what affect establishing a 401(k) system will have on the Army human resource management. I will look at what savings and investment programs are available through civilian agencies. I will also look at the other military services and determine if they tried to develop a similar program, and finally, has the lack of a savings and investment program somehow affected combat readiness.

What Effect Does the Program have on the Army Human Resource Management System?

"Every member of the service ought to be sitting out there thinking that those people in Washington are finally getting it!"

Senator Max Cleland[2]

The Army Human Resource Management System would not establish a 401(k) program. The Federal Retirement Thrift Investment Board would administer and manage the 401(k) program. That is the good news. Here is the bad news. The Army looks at a 401(k) program as a step toward civilianizing the military retirement system. Another important item to consider is that if Congress starts looking at desperate ways to come up with cost savings they may look at the military retirement system. This could happen because some in congress advocate an overhaul of the military retirement system.[3]

Soldiers currently have optional Individual Retirement Account (IRA) as their only deferred savings and investment program, whereas all other government and many public and private employees are eligible for other 401(k) type programs. Military members deserve the same opportunity to build a long-term savings program that will allow for tax-free accumulation of savings. It would definitely encourage voluntary, personal savings. What is unique about 401(k) type programs is that they provide a portable benefit to members not retiring. So soldiers that may not remain in the Army for full retirement benefits could leave the service and take their 401(k) program with them. The key is to decrement this as a penalty for leaving the service. This makes the retirement plan portable but at a cost.

What Role Does the Availability of Commercial Savings and Investment Programs have on the Necessity of an Army 401(k)?

> *"If a spouse or youngsters could have a college fund created or some kind of benefit there, I think that would go a long way toward helping retention."*
>
> Senator Max Cleland[4]

There are many different type savings and investment programs available not only to civilians but also to Army soldiers. Individual Retirement Accounts are the only instruments available to soldiers that offer a tax-deferred capability. A 401(k) account is very similar but it offers a couple of added benefits. Refer to Appendix A for a full description of a 401(k).

An IRA is very similar to a 401(k). The principal difference in a 401(k) and an IRA is that in a 401(k) the employer usually matches the employee contribution. Once vested which usually takes 3-7 years, depending on the program, the employee takes the entire account with him or her if the employee chooses to change jobs. Surveys indicate, only about 12 percent are expected to participate in a 401(k) program if the Army was to implement a program.[5] Since the IRA exists for all to participate, the soldiers that can afford it and care about saving for retirement do participate. Therefore, the availability of commercial savings and investment programs may not necessitate the Army to implement one.

What 401(k) Programs Are Available or Have Been Attempted By Other Services?

> *"We think the pay gap should be closed first…Then we can take a look at the pay tables."*
>
> Senate Aide – describing the six-year plan to close the pay gap[6]

There are numerous 401(k) programs available to civilian employees. There are, of course, no 401(k) programs available to active duty soldiers. The Air Force and the Navy have not implemented a 401(k)-type program but are researching its ramifications in their respective services. A preliminary look into a 401(k) program has taken place in the Army and the Army was looking at the Thrift Savings Plan as a model. The Thrift Savings Plan (TSP) is a retirement plan for federal civilian employees. It is set up as a 401(k)-type plan with a solid savings and investment foundation. Its primary purpose is to provide retirement income to federal employees. The TSP was setup as a defined contribution plan. All this means is that the retiree will receive as much in retirement income as he or she and the employer contributed to the account. The account will grow or decline in relation to the stock market. The Federal Retirement Thrift Investment Board controls the TSP.

Has the Lack of a Savings and Investment Program Affected Combat Readiness of the Army?

> *"If the proposal is approved, the post-1986 service members could continue to have reduced retirement benefits from the pre-1986 plan because of the COLA caps. What we want to know is why this difference is continuing if retirement benefits are such a big concern."*
>
> Senate Aid[7]

Can a 401(k) program improve combat readiness? I found that implementing a 401(k) program would not enhance combat readiness. I also determined that the lack of a 401(k) program has not led to a reduced level of combat readiness. Soldiers are more concerned about basic pay, quality of life, and amount of time separated from family and retirement benefits. The concern about retirement benefits is now more with soldiers who fall under the redux program. They feel shortchanged, and since the economy is doing so well, soldiers are voicing their dissatisfaction by exiting the Army. Soldiers do not join the Army for money or retirement benefits. However as they choose to stay in the Army and make it a career they see more senior soldiers retiring with better benefits.

The Army has instituted some stop gap programs to help retain soldiers in critical MOSs. Selective re-enlistment bonuses are used to give lump sum money to soldiers that serve in these hard to fill MOSs. This program temporarily helps keep soldiers in the Army, but it's not the answer to the problem.[8] The bottom line is that the lack of a 401(k) program has not effected combat readiness.

Notes

[1] Rick Maze, "Lawmakers Compete to Increase Pay and Benefits," *Army Times*, 25 January 1999, 18.

[2] Rick Maze, "Lawmakers Compete to Increase Pay and Benefits," *Army Times*, 1 February 1999, 18.

[3] Briefing Notes, Compensation and Entitlements Branch, subject: Uniformed Services Payroll Savings Plan, 6 May 1998.

[4] Rick Maze, "A GI Bill for the Family?" *Army Times*, 25 January 1999, 18

[5] Briefing Notes, Compensation and Entitlements Branch, subject: Uniformed Services Payroll Savings Plan, 6 May 1998.

[6] Rick Maze, "Raising the Ante," *Army Times*, 18 January 1999, 19.

[7] Rick Maze, "Upping the Ante on 2000 Pay Increase." *Army Times*, 11 January 1999, 3.

[8] Maj Hill and Maj Hauk, Information Paper on Deferred Incentive Program, 30 July 1998, 4.

Chapter 4

Is There a Benefit to the Soldier in a 401(k) Program?

> *"We will have to decide whether the military's greatest need is for more people or better pay, since we cannot afford to do both,"….."The chiefs have made it clear that better pay is their answer. In the end, I think Congress will reach the same conclusion."*
>
> House Republican Aide[1]

After researching this topic, I conclude that there are benefits to the soldier in implementing a 401(k) program. Soldiers will be able to begin a savings program on par with many of their civilian counterparts. The soldier can participate in a tax-deferred program with all the 401(k) protection and convertible capabilities. The 401(k) is a tremendous tool that if started early in life, can provide retirement freedom later in life that is greatly overlooked today. The issue is that the soldiers do not really care about a 401(k) program as indicated in the previous chapter. Soldiers want secure retirement benefits equal to the HTYP.

Congress and the Office of the Secretary of Defense are listening. There are recent proposals by both political parties and a separate proposal by President Clinton to increase the retirement benefits of all military members. The politicians are also proposing an increase to the GI Bill. Politicians are also exploring the transferability of GI Bill benefits to family members.[2]

There is also a proposal by both political parties to create a 401(k)-type program. One version would provide for government contributions and the other would not.

Notes

[1] Rick Maze, "Defense Budget Could See $20 Billion Boost," *Army Times*, 4 January 1999, 29.

[2] Rick Maze, "Lawmakers Compete to Increase Pay and Benefits," *Army Times*, 1 February 1999, 18.

Chapter 5

Summary

"Repeal of Redux is major step toward improving retention."

Pentagon Spokesman[1]

Should the Army implement a 401(k) program to improve recruitment and retention? This is the whole point to this paper and I believe I have gathered enough information to answer this thesis.

I reviewed the proposed changes to the military retirement system since 1993. There have been many initiatives to change and ultimately reduce the military retirement system. There is no doubt; the military has a good retirement system. But it has been significantly reduced from the FBPP to the HTYP and was reduced even further with the implementation of redux. I wanted to find out if there had been any savings and investment programs attempted for the military to take advantage. There had been talk of implementing some type of plan but that was all it turned out to be – talk.

I investigated what motivated a person to join the Army. Most recruits join for reasons other than money or some type of monetary payoff. Most join for the purpose of education, to learn a job skill, to travel or for patriotic reasons.

I analyzed the retention rate of soldiers and determined why soldiers get out of the military after serving an initial term and after a second term. I determined that most soldiers choose to leave the Army because of low base pay, reduced quality of life and increased amount of family separation. What is interesting to note here is that the category of retirement benefits is growing significantly as a reason for soldiers leaving the military. In a couple of years, at the current rate, retirement benefits will be the number one reason for soldiers leaving the Army.

In chapter three, I wanted to find out if the Army would benefit in implementing a 401(k) program. First, I looked at how implementing a 401(k) program would effect the Army Human Resource Management system and determined that there would be no additional duties or costs for the Army personnel offices. The Federal Retirement Thrift Investment Board would implement and administer the 401(k) program.

I looked at the availability of commercial savings and investment programs to soldiers. I found out that only 12 percent would take advantage of an Army 401(k) program. Soldiers currently have the option of taking advantage of IRAs for tax deferred savings.

Neither the Air Force nor the Navy has implemented a 401(k)-type program. Both services have explored the possibilities. The Air Force believes, like the Army, that a 401(k) implementation could open the door for a total review of the military retirement system by the Congress and neither service wants to risk this.

I also looked at the costs of in implementing a 401(k) program, and as I said earlier, it is estimated that only about 12 percent of the Army would be expected to participate in a 401(k) program. Even with that small number, the U.S. Treasury would lose about 95 million dollars in taxes. This loss would not be tolerated in an era of tighter and tighter budgets.

My research determined that the lack of a 401(k) program has not caused the current decline in recruitment or retention in the Army. If a 401(k) program would be implemented today, it would not change the recruitment or retention rates of the Army. I do believe, however, the implementation of a 401(k) program would be a positive addition as part of an overhaul of the current retirement system.

I set out to answer the above questions to the best of my ability and I think I have learned a lot about the current retirement system and its effects on our Army. The above are the facts and now it's time for a recommendation.

Recommendation!

> *"The idea that the Army pay scale is fair and adequate sinks or swims on what the soldier thinks, and what the soldier can receive for his experience and skills in the civilian sector."*
>
> Lt. Col. Richard Ballard[2]

I have an answer for my thesis statement, **"Should the Army Implement a 401(K) Savings and investment Program to Improve Recruitment and Retention of Soldiers?"** After all the analysis and research that was conducted, I know that the implementation of a 401(k) program would not greatly improve recruitment and retention. I believe that the implementation of a 401(k) program would not improve recruitment and retention for the following reasons:

First, soldiers do not join the Army for money. Most join for training, education and patriotism. Second, most soldiers choose to leave the Army for base pay, quality of life and family separation reasons. Reduced retirement benefits are a growing reason for soldiers choosing to leave the Army

Therefore, my recommendation is – If the Army is serious about increasing recruitment and retention, it must -

Conduct a comprehensive overhaul of military retirement benefits, including improved healthcare and an active duty pay raise. Surveys showed that retirement benefits were growing steadily as a reason for separation since 1992. At the current rate, retirement benefits will be the primary reason for soldiers leaving the Army. This fix must include changing the redux program to either the HTYP or the FBPP.

Notes

[1] Rick Maze, "Bigger Pay Raises, Better Retirement On Tap," *Army Times*, 28 December 1999, 3.

[2] Lt. Col. Richard Ballard, "Pulling Apart the Rand Study – Flaw by Flaw," *Army Times*, 28 December 1998, 19.

Appendix A

401(k) Defined

A 401(k) plan is a tax-deferred investment and savings plan that acts as a personal pension fund for employees. It allows employees of corporations and private companies to save and invest for their own retirement. In a 401(k) plan you authorize pre-tax payroll deductions to be invested in mutual funds or other investment options offered by your company's plan. Both the contributions and the investment earnings can grow tax-deferred until withdrawal (assumed to be retirement), at which time they are taxed as ordinary income.

401(k)s were established by the federal government in 1981 to encourage workers to establish retirement savings plans. The name refers to the relevant section in the Internal Revenue Code.

Your contributions are taken pre-tax, reducing your taxable salary, and both the contributions and earnings can grow tax-deferred until they are withdrawn. Tax-deferred contributions and earnings make up the best one-two punch in investing.[1]

You choose whether you want to participate in the company 401(k) plan. If you choose to participate, you them must decide how much you want to contribute. Under Employee Retirement Income Security Act (ERISA) regulations, the plan must offer a number of different investment options, which means you get to select your investments based on your own time horizon, risk aversion, and financial risk tolerance. 401(k) plans are also portable. When you change jobs, you do not have to leave your 401(k) behind. You can roll over your account into another employer's 401(k) plan or into an IRA.

Because participant contributions are typically a percentage of an employee's salary, which is more-or-less the same every pay period, you invest the same amount every pay period. This is what has termed dollar-cost averaging, a much-touted tenet of successful investing. To use the dollar-cost averaging strategy, you put the same amount of money into an investment at regular intervals, such as every month. Since, over the long term, the stock market has consistently risen, you are likely to end up buying more shares when prices are low and fewer shares when prices are high. In addition, you do not have to track the market and time your purchases (that is, buy low and sell high).

Employer contributions, which are optional, typically come in the form of what is called a "company match." These can range from 25% to 100% of your contribution to the plan, up to a certain limit. Most employers (over 80%) offer some type of this company match--both as an incentive for employees to join the plan and as part of the overall benefits package. Many consider these employer contributions the real attraction of the 401(k) account. In a plan where your employer is matching your contribution at 50 cents on the dollar, you've made an instantaneous 50% return.

Depending on your company's 401(k) rules, you may be able to contribute to a 401(k) in any year you earn a salary and are a regular employee. The administrative costs involved in setting up and maintaining a 401(k) plan generally makes it attractive only to companies with more than 25 employees.[2]

A 401(k) is different from a company pension plan in a few ways: With a 401(k) plan, benefits depend on individual contribution levels and portfolio performance. A pension plan has predetermined benefits based on final salary, years of service, and a fixed percentage rate.

You can roll a 401(k) account into another 401(k) plan or an IRA, but when you leave a company, your pension generally stays there.

Each participant in a 401(k) makes decisions for his or her own portfolio. A plan administrator makes decisions for the future "pensioners." The employees, along with (most) employers, fund the 401(k) plan while employers fund company pensions only.

Contributions to a 401(k) can come from both employees (often called participants) and employers. Participant contributions are called salary reduction contributions, because they are pre-tax deductions taken from each paycheck, which reduces your taxable salary. Some plans do allow after-tax contributions, which are taken from your net pay. The contribution is taken after-tax and is non-deductible, but the earnings grow tax-deferred until retirement, when they are taxed like ordinary income. Each year, the Internal Revenue Service sets a maximum contribution limit for 401(k) accounts. For the 1997 tax year, the employee contribution limit is $9,500.[3]

While the participant owns participant contributions (and their related investment earnings), employer contributions accrue to the participant over a period of time, typically between 3-7 years, called a vesting period. Over time, employer contributions are added to the participant contributions to become what is called the vested balance, which is owned by the employee.

Many plans allow loans to be taken from your 401(k) account. Once you reach a minimum vested balance (determined by the plan), you may be eligible to take a loan from your 401(k) account. Repayment takes place through automatic payroll deduction. In addition to repayment of loan principal, you also repay a fixed rate of interest to your account. In essence, you are borrowing from and repaying yourself.

Taking a loan from your 401(k) account can have significant consequences for the growth of the account. You miss the earnings growth that would have occurred if the loan amount were still in the plan. Additionally, unlike some loans, the interest payments on 401(k) loans are not tax deductible. Because these plans are meant for retirement savings, there are usually restrictions, including those on loan frequency and loan amount. Check with your plan sponsor for more details.

Withdrawals from 401(k) plans are often referred to as distributions. Assets in your 401(k) account can be withdrawn without penalty after age 59½. You must begin to withdraw money from your account no later than April 1 of the year following the year in which you turn age 70½. Distributions must be taken annually.

However, 401(k) plans do not actively promote the ability to withdraw money from your 401(k) account before age 59½. In fact, some plans require you to take a loan from the plan before you can take a withdrawal. Most plans offer the ability to withdraw from your 401(k), which, under IRS regulations, must be for an "immediate and heavy financial need."

If you leave your current employer, you do not have to leave your 401(k) behind. You can roll over your account directly into another qualified retirement plan, such as your new employer's 401(k) plan or an IRA, called a Rollover IRA.[4]

If you decide to take a distribution before age 59 1/2, the financial costs can be steep. In addition to a 10% premature withdrawal penalty, your plan sponsor is required to set aside 20% for federal withholding tax on the amount you don't rollover directly. This is only an estimate of the tax you will owe on the withdrawal--the actual amount will be determined when you file your taxes. If the vested balance in the account is over $3,500, most plans will let you leave it in the plan until age 70½ or retirement, whichever is later.

Notes

[1] *Solutions Handbook for Personal Financial Planning,* (Dearborn Financial Publishing, 1996), 224-230.

[2] Lee Rosenberg, *Retirement Ready or Not,* (Career Press, 1993), 11, 90-91, 161.

[3] Jane Bryant Quinn, *Making the Most of Your Money,* (Simon and Schuster, 1991), 434, 734,742, 743-748.

[4] Theodore J. Miller, *Kiplinger's Make Your Money Grow*, (Kiplinger Books, 1993), 372, 377-379.

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